No. 13,082

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN COSTELLO, Trustee of the Estate of Angelo Pagliaro, Bankrupt,
Appellant,

vs.

C. N. GOLDEN,
Appellee.

APPELLANT'S OPENING BRIEF.

SHAPRO & ROTHSCHILD,
155 Montgomery Street, San Francisco 4, California,
Attorneys for Appellant.

DANIEL R. COWANS,
155 Montgomery Street, San Francisco 4, California,
Of Counsel.

Subject Index

Table of Authorities Cited

Cases

Statutes

Rules

Texts

No. 13,082

IN THE

United States Court of Appeals

For the Ninth Circuit

JOHN COSTELLO, Trustee of the Estate of Angelo Pagliaro, Bankrupt,
Appellant,

vs.

C. N. GOLDEN,
Appellee.

APPELLANT'S OPENING BRIEF.

STATEMENT AS TO JURISDICTION.

This appeal is from an order of the United States District Court for the Northern District of California, Southern Division (dated July 23, 1951) (T.R. 35-43), reversing an order of the Referee in Bankruptcy dated March 6, 1951 (T.R. 13-15), which required the appellee to turn over to the appellant, a Trustee in Bankruptcy, certain funds which the Referee determined belonged to the general creditors of the Bankrupt. On September 5, 1950, the Bankrupt filed a Voluntary Petition in Bankruptcy under the provisions of Chapters I-VII of the Bankruptcy Act, U.S.C., Title 11, Chapters I-VII. Under an Order of Adjudication and Reference (T.R. 3-4), said

Bankrupt was on that day adjudicated bankrupt and the matter was referred to Hon. Bernard J. Abrott, Referee in Bankruptcy.

The case arose on a Petition for Turnover Order (T.R. 5-7) filed by appellant on January 18, 1951 with said Referee, the Answer to Petition of Trustee for Turnover Order and Petition for Reclamation of Assets Held by Trustee (T.R. 8-11) filed January 26, 1951 and the Answer to Petition for Reclamation of Assets (T.R. 12-13) filed January 30, 1951.

The United States District Court had jurisdiction under Section 23 of the Bankruptcy Act (Title 11, U.S.C., Section 46) to review the Order of the Referee on the Amended Petition for Review of Referee's Turnover Order and Denial of Petition in Reclamation (T.R. 18-21) filed pursuant to Section 39c of the Bankruptcy Act (Title 11, U.S.C., Section 67c).

The appellate jurisdiction of the Court is invoked under Section 24a of the Bankruptcy Act (Title 11, U.S.C., Section 47a), pursuant to a duly filed Notice of Appeal to Court of Appeals Under Rule 73-(b) dated August 6, 1951 (T.R. 43-44).

STATEMENT OF THE CASE.

The case, we believe, is one of first impression and is highly important in the administration of the Bankruptcy Act. We believe further, that the decision of this Court will affect the rights of creditors in every bankruptcy case in which contracts of the bankrupt

are not completely performed and thus will involve far more than a mere determination of the rights of these parties to the sum involved. The rule contended for by the appellee is contrary to the accepted practice in all or at least a substantial percentage of the bankruptcy cases in this District.

On July 7, 1950, the Bankrupt, Angelo Pagliaro, purchased the equipment, furniture and fixtures of a restaurant from the appellee C. N. Golden under a Contract of Conditional Sale for $4,776.00. He made a down-payment and went into possession of the premises of which the appellee was the lessee. His operation of the restaurant was ill-fated and on September 5, 1950, he filed his Voluntary Petition in Bankruptcy and was adjudicated a Bankrupt on that day. The property thereby passed into the custody of the Court for administration for the benefit of his creditors. At the time of the Petition in Bankruptcy, according to the Findings of Fact of the Referee (T.R. 29), the property was worth $4,750.00. As the balance then due upon the Conditional Sales Contract was $3,676.00, there was an equity of $1,074.00 available to the creditors.

On September 25, 1950, twenty days after the date of adjudication, at the First Meeting of Creditors, appellant John Costello was appointed Trustee of the estate.

On October 21, 1950, forty-six days after the date of adjudication, the appellee took this property from the custody of the Court without its permission. He did

not file the customary Petition in Reclamation but instead used unlawful self-help. He operated the restaurant for approximately thirty days and then sold it for $4,750.00. By this device, he obtained not only the profit on the original sales price, but as an additional profit, the equity available to the claims of creditors of the Bankrupt.

The Referee's Turnover Order required appellee to turn over to appellant $1,074.00, less $475.00 paid by appellee as a broker's commission on the resale.

In the subsequent hearing on the Petition for a Turnover Order and on the review by the District Court described above, the appellant contended: That the contract was not an "executory contract" within the meaning of Section 70b of the Bankruptcy Act (11 U.S.C., Sec. 110), requiring the Trustee to assume or reject it within sixty days of the date of adjudication so that his failure to assume did not foreclose any further claims; and that in any event the unlawful acts of self-help prevented the appellee from keeping the additional profit so obtained; and finally that the case was a proper one for equitable relief from forfeiture.

The appellee contended that the contract was an executory contract within Section 70b so that the Trustee's failure to assume it within sixty days terminated any rights he might have had and further that pursuant to provisions of the contract, he was entitled to keep payments made by the Bankrupt as liquidated damages.

Three questions are thus raised for consideration by this Court, which must decide if the appellee is entitled to keep his unlawfully obtained extra profits at the expense of the other creditors: (1) Is a Conditional Sales Contract in which the vendor has fully performed and the vendee has not, an "executory contract" within the meaning of Section 70b of the Bankruptcy Act? (2) Assuming such a contract where one party has performed is an "executory contract" within that Section, can the vendor by taking the property without permission of the Court before the statutory sixty-day period elapses, deprive the trustee of his statutory rights? (3) Do the facts present a proper case for equitable relief under California Civil Code Section 3275 from the forfeiture or loss in the nature of a forfeiture which will result if the appellee is permitted to keep at the expense of the general creditors, sums in excess of one hundred per cent of his sales price as an extra profit?

SPECIFICATION OF ERROR UPON WHICH APPELLANT RELIES.

Appellant specifies as error:

That that certain Order dated July 23, 1951, wherein and whereby the Order of Hon. Bernard J. Abrott, Referee in Bankruptcy, made in the above-entitled matter on March 6, 1951, was reversed, was erroneous and contrary to law in that

(2) the contract between appellee and the Bankrupt, at the date of the Petition in Bankruptcy was not an "executory contract" within the meaning of those words as used in Section 70b of the Bankruptcy Act;

(b) the unlawful taking of property from the custody of the Court by the appellee constituted a conversion of property entitling appellant to damages in the amount awarded by the above-mentioned Order of the Referee;

(c) the case is a proper one for equitable relief from forfeiture under California Civil Code Section 3275 entitling appellant to the amount awarded by the above-mentioned Order of the Referee.

ARGUMENT.

I.

"EXECUTORY CONTRACTS" AS USED IN SECTION 70b MEANS CONTRACTS IN WHICH SOMETHING REMAINS TO BE PERFORMED BY BOTH SIDES, OR AT LEAST CONTRACTS IN WHICH SOMETHING REMAINS TO BE DONE BESIDES THE PAYMENT OF MONEY.

Section 70b provides in part:

> "Within sixty days after the adjudication, the trustee shall assume or reject any executory contract, including unexpired leases of real property: PROVIDED, HOWEVER, That the court may for cause shown extend or reduce such period of time. Any such contract or lease not assumed or rejected within such time, whether or not a trustee has been appointed or has qualified, shall be deemed

> to be rejected. A trustee shall file, within sixty days after adjudication, a statement under oath showing which, if any, of the contracts of the bankrupt are executory in whole or in part, including unexpired leases of real property, and which, if any, have been rejected by the trustee: PROVIDED, HOWEVER, That the court may for cause shown extend or reduce such period of time * * *"

To interpret the word "executory" as used in Section 70b, we must consider what Congress intended to accomplish by its insertion in the Chandler Act of 1938. Most of the usual aids to interpretation of statutes are of no avail in this instance. The Bankruptcy Act itself contains no definition of the words in question. Nothing has been found in the legislative history of the section which sheds light on the meaning of the words. There was no similar provision in the prior Bankruptcy Acts. The legislative material indicates the section was inserted to codify some former case law which fixed no period of time for acceptance or rejection. *Weinstein, The Bankruptcy Law of 1938, A Comparative Analysis Prepared for the National Association of Credit Men* (1938) 159-160. (Judge Weinstein was the draftsman for Congressman Chandler.) No case has been cited nor can any be found which deals precisely with the question. The only case found which attempts to define the phrase "executory contract" as used in the Bankruptcy Act supports the contention of the appellant. (*In re San Francisco Bay Exposition* (1943), 50 F. Supp. 344; which will be discussed infra.)

Thus we must examine the language of the section and attempt to determine the problem the section was designed to meet.

At the outset we note that the phrase "executory contract" is ambiguous and the Bankruptcy Act contains no definition of it. *Williston on Contracts* (1936 ed.), Section 14 states:

> "* * * The same criticism, so far as ambiguity is concerned, applies to the phrase 'executory contracts.' All contracts to a greater or less extent are executory. When they cease to be so, they cease to be contracts."

It is perfectly obvious that Congress was not concerned with fully executed agreements, for the trustee would have no concern with completed deals which were no longer contracts. It was concerned rather with agreements in which something was left to be done either by the bankrupt or the other contracting party, or both, because in such uncompleted agreements there would be assets to recover for the estate, or liabilities to liquidate insofar as possible or perhaps both. If it had been the intention of Congress to cover every agreement in which something remained to be done, that is, everything which could properly be called a contract, it would have been sufficient to state that the trustee must assume or reject "any contract". But Congress added the word "executory" and by the principles of statutory interpretation as recently stated by this Court (*Sampsell v. Straub* (1951), 189 F. (2d) 379), we must give effect to every word of a statute if possible.

There is a reasonable interpretation to give effect to the added adjective "executory" which is supported by case law and by the opinion of one of the leading commentators on bankruptcy law. Executory contracts within the meaning of Section 70b are contracts in which something remains to be performed by *both* parties. The opinion written by Hon. Louis E. Goodman of the United States District Court for the Northern District of California in *In re San Francisco Bay Exposition,* supra, supports this position. Therein the Court states at page 346:

> "The referee assumed that any contract not completely performed by either party is executory in the sense which gives rise to the right of disaffirmance. Upon that assumption he held that the Building and Loan Commissioner could disaffirm the subscription agreement, because even though the Exposition had performed, the Commissioner had not; ergo, the contract was executory and the Commissioner could disaffirm. In a literal sense, executory contracts are of course, those wherein performance in whole or in part has not been had. Upon that general premise, without further distinction, the Referee bottomed his decision. *In the sense used in both the California Statute and the Bankruptcy Act, they (i.e., executory contracts) are the type of contracts which call for performance in futuro, such as leases, contracts for electric power, light, heat, delivery of commodities, services and the like."* (Emphasis ours.)

Where the vendor in a conditional sales contract has delivered the items sold, there is no future per-

formance due by him, and in line with the above decision, such a contract is not an executory contract within the meaning of Section 70b although it might be executory under non-bankruptcy definitions.

A similar view is expressed in 4 Collier on Bankruptcy, page 1228. In a somewhat more extensive discussion the author explains that the language of Section 70b is broader than the intended coverage, and sets forth the problem which the section was designed to meet. After explaining that the section was a codification of prior case law which provided no fixed time for acceptance or rejection, Collier states:

> "On the other hand a statutory rule of law should be more exacting as to its wording than a statement of the law of a case. In this respect, Section 70b is not free from ambiguities. It refers to 'any executory contract.' As already pointed out in connection with similar language in Section 63a(9), the term 'executory' as applied to a contract is equivocal and of little practical value. As long as there remains any part of a contract unperformed, the contract is executory, and subdivision b of Section 70 even emphasizes this broad scope of the term by speaking of contracts of the bankrupt that are executory 'in whole or in part.' Now if a vendor sold merchandise to a subsequently bankrupt purchaser and conveyed unconditional title to him, but the bankrupt failed to pay any part of the purchase price, the contract is certainly 'executory.' And yet it is obvious that this is not the situation in which the trustee is under Section 70b called upon to assume or reject. The vendor, unless secured, will file his proof

> of claim for the entire purchase price, and what the trustee will do is possibly to *object* to the claim but not to *reject* or assume the contract. In the converse case, suppose the bankrupt is not the purchaser but rather the vendor who prior to bankruptcy sold and conveyed title, his solvent debtor and purchaser failing to pay the price. Again, the sales contract is clearly executory 'in part.' Yet what the trustee will do is either to prosecute and enforce or to abandon the bankrupt's claim and right of action transferred to the trustee by operation of law, but there would be no thought of either assuming or rejecting the contract however executory it might be. *Thus Section 70b obviously purports to say more than it intends to say.*" (Emphasis on the last sentence ours.)

We quite agree with the author when he indicates what would be the actual practice in the event of a purchase by the bankrupt where the items were delivered or of a sale by the bankrupt where he had delivered. In those instances there would truly be no thought of assuming or rejecting and such has been the practice. Yet the author notes that these are contracts which are "executory in part". He is perplexed and concludes that the section says more than it intends. This imputes confusion and misunderstanding to the draftsmen of the section.

The proper answer is that "executory" in the bankruptcy sense does not mean the same as "executory" in the non-bankruptcy sense. In the instances in which Collier states there would be no

thought of assumption or rejection, the contracts are those in which complete performance has been rendered on one side. They are executory in the non-bankruptcy sense, but they are not executory in the bankruptcy sense because there is no performance in *in futuro* due from both sides as was suggested as necessary in the *San Francisco Bay Exposition* case, supra. Only by this view can the confusion be avoided. Only by this view can the conclusion that the draftsmen did not understand the problem be avoided.

Collier appears to be misled by the following sentence of Section 70b:

> "A trustee shall file within sixty days after adjudication, a statement under oath showing which, if any, of the contracts of the bankrupt are executory *in whole or in part,* including unexpired leases of real property, and which, if any, have been rejected by the trustees * * *" (Emphasis ours.)

He seems to conclude that a contract executory "in whole" is one where neither party has performed, and a contract executory "in part" is one where one party has performed and the other party has yet to perform. If this were the only possible interpretation, the conclusion of confused draftsmanship would be correct. We think, however, that the better view is that within the meaning of Section 70b, a contract executory in part is one in which part of the performance by one or by both parties has been performed but there remains a part of the performance to be rendered by both parties. A simple example is

a contract for the purchase of two items. The contract is executory in part if only one of the items has been delivered or if a down-payment has been made, without full delivery, or if one of the items has been delivered and paid. In such cases, there is performance due from both parties.

The explanation by Collier of the legislative purpose in adding Section 70b contains a strong indication that Congress was thinking in terms of mutuality of performance. He states in Volume 4 at page 1229:

> "The legislative intent back of Section 70b and the purpose of the provision is to solve the problem of *assumption of liabilities.*" (Emphasis of the author.) "It is conceivable that a system of bankruptcy might compel the non-bankrupt party to a contract, the performance of which is *incomplete as to both contracting parties,* to continue performing while for the counterpart to refer him to a mere dividend out of the estate. Needless to say, such a solution is neither wise from the viewpoint of commercial credit, nor fair from the viewpoint of equity. It neglects one of the basic principles of equity, *mutuality of obligation and performance.* What Section 70b actually proposes to do is precisely to secure this continued mutuality wherever it is felt to be of greater benefit to the estate to proceed in accordance with the debtor's plans rather than to freeze his commercial relations as of the filing date." (Emphasis ours.)

Our view that executory contracts in Section 70b means contracts in which performance remains due on

both sides is the one that meets the Congressional concern for mutuality of obligation and performance.

A vendor of a conditional sales contract who has delivered has performed completely at the date of bankruptcy. He does not need to execute a conveyance or a bill of sale. Payment or tender by a purchaser vests title in the purchaser whether the payment is voluntary or through legal proceedings. *Arnois v. Bell* (1924), 70 Cal. App. 222, 232 Pac. 758; *Casady v. Fry* (1931), 115 Cal. App. Supp. 777, 6 Pac. (2d) 1019. Therefore, such contracts are not executory for the purposes of Section 70b.

We believe that Congress intended the words "executory contracts" to cover contracts in which performance remained due from both parties. However, even if Congress did intend to include *some* contracts in which performance remained due from one party only, we submit that they did not mean contracts in which the only thing left to be done was the payment of money. Surely a trustee need not assume or reject an obligation to pay a debt. Regardless of whether he assumes or rejects, the creditor can file a claim to collect his debt. As Collier explains in the section hereinabove quoted, what the trustee will do is to *object* to the claim if he has any valid ground for objection. He cannot deprive the creditor of his day in Court by his rejection out of Court. Must he reject out of Court and then object in Court? We think not. On the other hand, the trustee must pay all claims with which he has no dispute. Must he then promise

to do something he is legally obligated to do? We think not. If the trustee is required to assume or reject an obligation to pay money, he is required to do an idle and superfluous act.

In re San Francisco Bay Exposition, supra, supports the view that a contract is not executory if the only thing remaining to be done is the payment of money. The case involved a subscription agreement. All the parties had subscribed except the Building and Loan Commissioner. The contract was performed except for the obligation for payment of money by the Commissioner who contended that under those facts the contract was executory. Judge Goodman held, however, that the contract was not executory within the meaning of the California statute and the Bankruptcy Act.

Cases on the law of corporations show that contracts are no longer executory if nothing remains to be done but the payment of money. The usual situation shows the corporation attempting to avoid payment of money under a contract after receiving the benefits of the performance by the other party by claiming that the contract was *ultra vires.* The courts answer that if the contract were executory, they would not enforce it, but if the corporation has received the benefits of performance, it cannot refuse to pay for it with the defense of *ultra vires.* In *Bradley v. Ballard* (1870), 55 Ill. 413, the Court states:

> "While a contract remains executory, the powers of corporations cannot be extended beyond their

> charter limits for the purpose of enforcing it. Not only so but on the application of a stockholder, or of any person authorized to make the application of a stockholder, or of any person authorized to make the application, a court of chancery would interfere and forbid the execution of a contract ultra vires. * * * But if one of the contracting parties proceeds in the performance of the contract, expending his money and his labor in the production of value, which the corporation appropriates, we can never hold the corporation excused from payment on the plea that the contract was beyond its power."

The *Bradley* case was quoted with approval in *Main v. Casserly* (1885), 67 Cal. 127.

II.

IF A CONDITIONAL SALES CONTRACT IS AN EXECUTORY CONTRACT WITHIN SECTION 70b, THE TRUSTEE IS ENTITLED TO 60 DAYS TO ASSUME OR REJECT. A VENDOR CANNOT BE PERMITTED TO SHORTEN THE TIME BY UNLAWFUL REPOSSESSION.

Even if we are in error in our view that an executory contract within Section 70b is one where performance remains due on both sides, the Order of the Court below should be reversed. If such a contract is executory, the trustee is given sixty days from the date of the adjudication to assume or reject. The trustee should have possession of the property in order to have it appraised and make it available for the examination of prospective purchasers. If the vendor is permitted unlawfully to repossess before the trustee

has had the sixty-day opportunity given by statute to make a careful choice whether to assume or reject, then the law is not that the trustee has sixty days to assume or reject but that the trustee only has until the vendor unlawfully seizes the property to make his choice. It is certainly no answer that even though the vendor has seized the property, the trustee until the expiration of the sixty-day period can always notify the vendor that he assumes the contract and force him to return it because this would force a blind choice on the trustee.

Repossession by the vendor without leave of Court is a conversion. Section 70a of the Bankruptcy Act vests in the trustee the title of property owned by the bankrupt. The bankrupt as purchaser under a conditional sales contract was the beneficial owner of the property sold. *Bowden v. Bank of America* (1951), 36 Cal. (2d) 406, 224 Pac. (2d) 713. Therefore, the trustee as beneficial owner of this property, being charged by Section 47a(1), 11 U.S.C. Section 75, with the duty of collecting the property and reducing it to money can maintain an action for conversion of the property and in so doing can obtain the proceeds of the property converted. This is precisely what the trustee has done in this case. The Trustee need not bring a plenary suit for conversion. The property of the bankrupt having been in the bankrupt's possession at the date of bankruptcy, it thereby passed into possession of the bankruptcy court giving it summary jurisdiction. The petition for a turnover order invoking summary jurisdiction is the equivalent of a conversion suit in a plenary action. The

trustee was merely using the expeditious procedure available to him under the Bankruptcy Act.

If a conditional sales contract is an executory contract and the conditional vendor had repossessed more than sixty days after bankruptcy, it would be an entirely different situation. In that case the trustee's failure to assume the contract within sixty days would be an abandonment of his interest and he would no longer have any property interest to be converted. He could no longer institute a turnover proceeding. But such is not the case here. In this case the trustee had a property interest for sixty days, and it is that property interest which was converted by seizure *before* the elapsing of that time. It is for the wrongful taking of that interest that the Referee ordered the appellee to pay over the value of such interest.

III.

APPELLANT IS ENTITLED TO EQUITABLE RELIEF FROM FORFEITURE UNDER CALIFORNIA CIVIL CODE SECTION 3275.

Section 3275 provides:

> "Whenever, by the terms of an obligation, a party thereto incurs a forfeiture, or a loss in the nature of a forfeiture, by reason of his failure to comply with its provisions, he may be relieved therefrom upon making full compensation to the other party, except in case of a grossly negligent, willful, or fraudulent breach of duty."

Federal Courts will apply this section in a proper case and indeed this Court has recently applied it.

Title Insurance and Guaranty Co. v. Hart (U.S.C.A. 9th, 1947), 160 Fed. (2d) 961.

There is a forfeiture or a loss in the nature of a forfeiture in this case. The bankrupt had an equity of $1,074.00 in the property. If the appellee is permitted to keep that equity for himself in addition to 100% of the sales price, the estate will suffer a loss in the nature of a forfeiture. The forfeiture is incurred by reason of failure to comply with the provisions of the contract calling for payments.

The section also requires full compensation to the other party as a condition for relief of the party invoking the section. Where the other party by his own wrongful acts deprives the invoking party of the means with which to make compensation but in the process obtains full compensation, a court of equity will find the requirement of compensation met. Unless this is true, then a court of equity will permit a party to profit by his own wrong.

Section 3275 has been held applicable to contracts of conditional sale of personalty. In *Miller v. Modern Motor Co.* (1930), 107 Cal. App. 38, 290 Pac. 122, the conditional vendor of an automobile repossessed for non-payment. The Court held Section 3275 applicable and permitted the buyer to have the automobile upon payment of the entire balance due on the purchase price.

The contract in the instant case is likewise one for the conditional sale of personal property, and the facts justify the application of Section 3275. It would be difficult to find a more compelling case for the in-

tervention of equity. Many creditors will receive only a small percentage of their claims as dividends from the estate. One creditor in violation of legal procedures has seized and sold an asset of the estate, obtaining for himself funds far in excess of 100% of his claim. A court of equity is asked to require him to remit the amount in excess of 100% under a code section authorizing such relief.

CONCLUSION.

In conclusion it is respectfully submitted that the Order of the District Judge reversing the Order of the Referee should be reversed because (1) contracts in which performance by one party is completed are not executory contracts within the meaning of Section 70b; (2) or even if they are, the wrongful act of retaking without permission before the statutory period of sixty days had elapsed was a conversion entitling trustee to pursue the summary remedy provided therefor in the Bankruptcy Act which he did so pursue; (3) and finally, the case is a proper one for relief for forfeiture under California Civil Code Section 3275.

Dated, San Francisco, California,
November 30, 1951.

Respectfully submitted,
SHAPRO & ROTHSCHILD,
Attorneys for Appellant.

DANIEL R. COWANS,
Of Counsel.